Banking and Finance Law Daily Wrap Up,FINANCIAL STABILITY—‘Bold, transformational solutions’ needed to end TBTF,(Feb. 17, 2016)

By John M. Pachkowski, J.D.

In his first speech as President and CEO of the Federal Reserve Bank of Minneapolis, Neel Kashkari offered his assessment of the current status and outlook for ending the problem of too big to fail banks.

Kashkari offered his assessment at the Hutchins Center on Fiscal & Monetary Policy at the Brookings Institution and noted that he “come[s] at this problem from the perspective of a policymaker who was on the front line responding to the 2008 financial crisis.” From 2006 to 2009, Kashkari served in several senior positions at the U.S. Department of the Treasury. In 2008, he was confirmed as assistant secretary of the Treasury. In this role, he oversaw the Troubled Assets Relief Program during the financial crisis.

Not far enough. Since enactment of the Dodd-Frank Act, Kashkari observed, “significant progress has been made to strengthen our financial system,” but he believes that Dodd-Frank “did not go far enough” and that the biggest banks are still too big to fail and continue to pose a significant, ongoing risk to our economy. He further indicated that “Now is the right time for Congress to consider going further than Dodd-Frank with bold, transformational solutions to solve this problem once and for all.”

Going forward. To complete the work begun with the Dodd-Frank Act, Kashkari put forth a number of options which included:

- breaking up large banks into smaller, less connected, less important entities;
- turning large banks into public utilities by forcing them to hold so much capital that they virtually can’t fail (with regulation akin to that of a nuclear power plant); and
- taxing leverage throughout the financial system to reduce systemic risks wherever they lie.

Kashkari found the many arguments against adoption of a more transformational solution to the problem of TBTF in that societal benefits of financial giants somehow justify the exposure to another financial crisis as “unpersuasive.”

He acknowledged that any bold plan will be “imperfect,” and there will be “unanswered questions,” but added, “if we are serious about solving TBTF, we cannot let them paralyze us.”

He continued, “Perfect cannot be the standard that we must meet before we act. Better and safer are reasons enough to act. Otherwise we will be left on the default path of incrementalism and the risk that we will someday face another financial crisis without having done all that we could to protect the economy and the American people.”

#EndTBTF. To begin the process, Kashkari noted that the Minneapolis Fed has begun an initiative—#EndTBTF—as an actionable plan to end TBTF. The initiative is to begin with a series of policy symposiums to explore various options from expert researchers. Following the symposiums, the Minneapolis Fed will publish a series of policy briefs summarizing key take-aways on each issue. Finally, by year’s end, the Minneapolis Fed intends to release its plan to end TBTF for legislators, policymakers, and the public to consider and provide feedback.

Reaction to Kashkari’s options to end TBTF was mixed.

Better Markets President and CEO Dennis Kelleher said, “Minneapolis Fed President Kashkari’s voice is a welcome addition to the important debate about ending too-big-to-fail firms, which caused the 2008 financial crash, almost caused a second Great Depression and caused more than $20 trillion in economic damage to the US. He correctly recognizes that too-big-to-fail firms continue to threaten not only the financial system and the economy, but also the jobs, homes, savings and livelihoods of all Americans. While the devil is in the details, we welcome the Minneapolis Fed’s initiative to propose transformational change by year-end that will end the dangerous too-big-to-fail firms once and for all.”

On the other hand, John Dearie, acting CEO of the Financial Services Forum noted, “The largest financial institutions are smaller and less complex with twice the capital and triple the liquidity since Mr. Kashkari left government to enter politics. The Fed’s stress tests show that large financial institutions can withstand a crisis far worse than 2008, and the largest banks have ‘living wills’ to guide an orderly wind-down without putting taxpayer money at risk. Of the ten largest global financial institutions, only a few are U.S.-based. Breaking up the U.S.-based global financial institutions would ensure that one of the U.S.’s most competitive global industries serving companies small and large is turned over to banks based outside the United States.”

Companies: Better Markets; Brookings Institution; Financial Services Forum

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